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**REPORT ON THE FORUM**

**“AFTER FIFTEEN YEARS OF MARKET REFORMS IN TRANSITION ECONOMIES:**

**NEW CHALLENGES AND PERSPECTIVES FOR THE INDUSTRIAL SECTOR”**

**Palais des Nations, Geneva, 24 and 25 May 2005**

1. The Annual Forum “After Fifteen Years of Market Reforms in Transition Economies: New Challenges and Perspectives for the Industrial Sector” was held on 24 and 25 May 2005 at the Palais des Nations, Geneva. It was organized by the United Nations Economic Commission for Europe (UNECE) in conjunction with the ninth session of the Committee for Trade, Industry and Enterprise Development.

Introduction

2. The Forum brought together about 120 representatives of Governments, non-governmental organizations, private companies and academia from 39 UNECE member countries. Over half of the participants represented transition economies, and about 15 per cent of these represented the new East European Member States of the European Union. Also participating were the United Nations Conference on Trade and Development (UNCTAD), the International Trade Centre/UNCTAD/WTO, the United Nations Economic Commission for Africa, the Agency for International Trade Information and Cooperation (AITIC), the Black Sea Economic Cooperation organization, the European Commission, the European Bank for Reconstruction and Development (EBRD), and the World Bank.

3. The Director of the UNECE Division for Industrial Restructuring, Energy and Enterprise Development opened the Forum, highlighting the major achievements of the transition countries during the last 15 years. He noted the progress they had made in creating democratic institutions and transforming their centrally planned economies to market-oriented ones. He said that major reforms in the industrial sector had resulted in institutionalized property rights, privatized and restructured State-owned enterprises, and a considerable improvement in the legal and regulatory environment for entrepreneurship. However, many of these countries, especially in the former Soviet Union and in south-east Europe, were still recovering from the economic downturn associated with the transition and the drastic changes in the political map of the region. They were still experiencing a decline in output, insufficient investment, high unemployment and large income disparities. But in those countries where the transition had been completed or was close to completion, policy attention had shifted from economic reform to economic development, economic growth and employment generation. Within that new policy agenda, international competitiveness, entrepreneurship and the restructuring of economies towards knowledge-based industries had become of paramount importance. In conclusion, the Director urged participants to reflect on the issues that the industrial sector would have to address in order to survive as a competitive segment of the rapidly growing knowledge-based economy.

#### Summary of discussion

4. Participants discussed both the lessons learned from the economic and industrial restructuring in the UNECE region and the future prospects. They reflected on the driving forces of the ongoing transformation in industry in the transition economies. They also examined the impact of industrial restructuring on small and medium-sized enterprises (SMEs) and analysed good practices in entrepreneurship and SME development in the Baltic countries. A special session was dedicated to the role of information and communication technologies in industrial development, and the increasing role of the knowledge-based sectors in the modern economy. A round-table discussion brought together representatives of private companies from transition economies, to address ways and means of fostering restructuring in the manufacturing sector. .

5. The presentations showed that considerable progress had been made during the years of industrial reform. In particular, this could be seen in the privatization of the bulk of industrial enterprises, in the large inflow of foreign direct investment (FDI), in enhanced research and development and innovation, as well as the impressive growth of high value-added and knowledge-based industries in the more advanced countries. In those countries, the industrial companies, primarily in the new EU Member States, had improved the quality of their goods, reduced the productivity gap and upgraded their export specialization, moving from labour-intensive exports to exports of engineering and other high-technology goods.

6. Restructuring had also been successful in a number of industrial sectors in the CIS (e.g. coal and steel). At the same time, market reforms had sometimes had a negative impact in industry, mainly in the countries of south-east Europe and the former Soviet Union: for example, there occurred a steep drop in industrial output, which continued in most countries of the region; a dramatic decrease in industrial employment not counterbalanced by enhanced employment opportunities in other sectors; and increased poverty in towns and areas dominated by enterprises and industries that had lost competitiveness owing to the opening of markets.

7. Major industrial players in the transition economies understood that neither Governments nor the private sector alone could cope with the daunting challenges of restructuring. Increasingly they emulated the best practice of industrial transformations in developed market economies. This implied close collaboration among all stakeholders, i.e. central and local government, private companies, labour unions and the local population. Case studies had shown consensus-based problem-solving in industrial restructuring to be a prerequisite for success.

8. In south-east Europe persisting productivity gaps and lack of structural adjustment maintained the export specialization in labour-intensive goods. At the same time, the current beneficial world price situation contributed to the preservation of one-sided raw material and fuel export specialization of countries rich in natural resources (such as the Commonwealth of Independent States). Participants believed that government efforts towards diversifying the industrial structure and increasing the high value-added component of the output were vital for the future integration of those countries in the knowledge-based world economy of the future.

9. The Forum discussed the financial aspects of industrial development, as well as the role of FDI in the industrial sector. The financial involvement of EBRD in industrial restructuring was primarily through co-financing. The Bank had recently financed various restructuring schemes, including the establishment of joint ventures (e.g. a car factory in Togliatti, Russian Federation), complex privatization projects (an aluminium smelter in Slovakia) as well as capital-intensive undertakings in the energy field (the Barents sea project in Russia).

10. Reforms in transition country industries would have been much more difficult to implement without the inflow of finance and technology associated with FDI. While on the global scale the accumulated stock of their FDI represented less than 4 per cent of world stock, it had nevertheless played a catalytic role in the economic restructuring. The speakers emphasized that the inflow of capital from abroad had been instrumental in the growth of the private sector. In many cases it had also attracted the financial resources needed for restructuring capital-intensive sectors (e.g. in the steel industry in Kazakhstan). While fostering structural change, FDI had also contributed to the export competitiveness of industry and had helped local enterprises enter the global supply chains. The participants generally agreed that countries that were still lagging behind in the transition to a market economy should endeavour to improve the legal, institutional and infrastructural conditions for FDI.

11. A number of speakers pointed out that the sustainable development of industry in the region strongly correlated with the development of entrepreneurship and SMEs. While in the most advanced transition economies the SME sector had shown spectacular achievements, in many countries it still suffered from a lack of financial resources, inadequate regulatory and institutional framework, insufficient information on administrative requirements for start-ups, poor property rights enforcement, lack of a skilled workforce and poor training opportunities for would-be entrepreneurs.

12. Participants agreed that, despite differences in the policy priorities of the various subregions, entrepreneurship and SMEs should nevertheless be supported through consistent and active national policy. In less advanced economies, it might be made a public-policy priority to establish a regulatory and institutional environment conducive to entrepreneurship and enterprise development. In more advanced countries, the focus should be on strengthening the competitiveness of enterprises in traditional industries, on introducing new technologies and developing technology-intensive sectors, as well as on modernizing public-sector services.

13. Governments should make it a priority to educate and train entrepreneurs. Such training should start already at secondary school level. The specialized institutions supporting the financing and exports of SMEs should be also strengthened. International organizations, and UNECE in particular, should ensure that the information on best practices in fostering SMEs be shared among the countries in the region to help them in designing related policies.

14. The recent experience of the Baltic countries had proved that the strong network of SME-supporting institutions and active government policy were key factors in successful SME promotion. In broader terms, close dialogue between major stakeholders, i.e. Governments, the business community, trade unions and the population at large, contributed to social consensus on the objectives and tools to be used in restructuring industry and fostering entrepreneurship. The speakers also stressed that for small economies lacking resources it was vital that Governments both supported SMEs and invested in research and development, thereby laying the basis for future competitiveness.

15. In Turkey, for instance, the development of information and communication technologies had benefited from active government policy in the area of enterprise development. Special financial instruments had been designed to help SMEs adopt information technologies, as well as to assist new ICT-based start-ups. As a result, in spite of a number of obstacles, including high taxes and inadequate export marketing, Turkey had improved its capacity to host outsourced activities, such as call centres, for instance.

16. Participants believed that post-transitional industrial development in Europe would increasingly depend on international sectoral-policy coordination, the development of common infrastructure networks, as well as the transfer of knowledge and know-how to disadvantaged countries in the region. At the same time, many of the speakers linked the future of industry both in developed market economies and transition economies to the emergence of a new type of economy decisively dependent on knowledge.

17. A number of countries in transition had comparative advantages in knowledge-related assets, e.g. a high level of education and general culture of the population, a record of excellence in advanced technologies, and world-class programmers and software. The challenge was to combine this potential with practical business models, which would then bring about enhanced competitiveness. In technical terms, this would imply creating an adequate information infrastructure, and strengthening the Internet capacity and IT-intensity of the transition economies. In regulatory and institutional terms, the development of the knowledge-based economy would require the rule of law to be firmly in place. Governments should also facilitate the inculcation of the culture of innovation and risk-taking, fostering, inter alia, the development of venture capital schemes.

18. Eventually, the new members of the European Union would have to move away from labour-cost-based competitiveness. For the less advanced transition countries, for example, for those of South East Europe, which in many cases have just started their migration from agriculture and manufacturing to more knowledge-intensive activities, including services, this task would be even more challenging.

19. Nowadays, size, geography and history did not constrain comparative advantages as they used to do in the past. Smaller economies and smaller firms could often prove more agile and 'e-ready' than larger ones. The example of Finland shows that external shocks could stimulate upward industrial restructuring, and that a medium-sized economy could move quickly from a traditional base (i.e. forestry) to knowledge-intensive clusters, for example in ICT. Strong government support for research and development had been an important factor of success in Finland's restructuring.

## Conclusions

20. The Forum agreed that over the past 15 years the transition countries in the UNECE region had made impressive progress in integrating their industrial sectors into the European and world economy. This progress could be seen not only in low value-added mineral resource extraction sectors but also in high value-added manufacturing and R&D-intensive industries.

21. The Forum identified a number of areas where market-oriented transformations had yet to bear fruit. Among those were the sectors in which the output was based on ICT and which would enhance the efficiency of industry in the future. Participants also noted that while the process of restructuring in industry was relatively well documented, similar processes in the service sector still needed to be examined. Research in such areas might be an objective for UNECE in the future.

22. Participants considered private entrepreneurship and SMEs to be the cornerstone of sustainable industrial development and employment growth. They suggested that UNECE might therefore consider focusing its programme on ways and means of fostering new enterprises: for example, on establishing an enabling legal and regulatory environment, on educating and training entrepreneurs, on revitalizing the entrepreneurial culture in transition societies and on strengthening financial institutions supporting SMEs.

23. The Forum recommended that the UNECE secretariat make the materials of the Forum available to the Governments of the region and the public at large. It also invited UNECE to summarize the discussion in an analytical report, which would facilitate the follow-up action by the subsidiary bodies of the Committee for Trade, Industry and Enterprise Development.

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